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GRAY DRUG STORES, INC.

ANNUAL REPORT TO SHAREHOLDERS . . .

FOR THE YEAR ENDED JUNE 30, 1951

GRAY DRUG STORES, INC.

MAIN OFFICE AND WAREHOUSE—2400 SUPERIOR AVENUE
CLEVELAND, OHIO

LABORATORY—1707 CRAWFORD ROAD
CLEVELAND, OHIO

BOARD OF DIRECTORS

CARLYLE W. EVANS.....Executive Vice-President, Gray Drug Stores, Inc.
HENRY H. GRAY.....Vice-President, Gray Drug Stores, Inc.
FRANK E. JOSEPH.....Partner, Jones, Day, Cockley and Reavis
CHARLES B. MERRILL.....President, Merrill, Turben & Co.
GEORGE F. PRYOR.....Vice-President, The Cleveland Trust Company
ADOLPH WEINBERGER.....President, Gray Drug Stores, Inc.

OFFICERS

ADOLPH WEINBERGER.....President
CARLYLE W. EVANS.....Executive Vice-President
HENRY H. GRAY.....Vice-President
MILTON M. NEUBAUER.....Vice-President
LLOYD C. DOUGLASS.....Treasurer
LOUIS BERWITT.....Secretary
JOSEPH VALINS.....Assistant Secretary

TRANSFER AGENT AND REGISTRAR

THE CLEVELAND TRUST COMPANY.....Cleveland, Ohio

AUDITORS

ERNST & ERNST.....Cleveland, Ohio

COUNSEL

JONES, DAY, COCKLEY and REAVIS.....Cleveland, Ohio

REPORT TO SHAREHOLDERS

Cleveland, Ohio,
September 10, 1951.

To our Shareholders:

The results of your Company's operations for the fiscal year ended June 30, 1951, are presented in this report.

Net income for the year, after deducting all charges including taxes, was $324,702, or $2.32 a share of Common Stock, as compared with $2.03 a share for the preceding year and $1.73 a share for the year before that. There are now 140,150 shares of Common Stock outstanding as against 139,000 a year ago.

Net operating profit before taxes (which excludes profit on the sale of stores and all other non-operating income) was $637,886, or 3.79% of net sales, as compared with $406,420, or 2.66% of net sales, for the preceding year. In my letter to you a year ago I discussed the probable effect of future tax rates on our earnings. In that connection, you will note that the provision for taxes on income for the past year was $340,000 as compared with $155,000 for the preceding year, and we may have to meet even higher tax rates in the years to come.

Despite the heavy tax burden, the net income for the year evidences the soundness of the program we embarked upon to improve our stores and strengthen our competitive position. We intend to press forward with this program and will continue our efforts to replace smaller stores with larger units so as to permit more efficient and economical store operation. During the year the Company sold five and closed two of its smaller stores, opened four new stores and remodeled nine stores. Total stores operated at the end of the fiscal year were seventy-four, or three less than a year ago. Despite this reduction, net sales for the past year were $16,833,818 as compared with $15,283,817 for the preceding year, an increase of approximately 10%. This growing sales volume has made additional warehouse facilities essential, and the Company is now building an addition to

its warehouse in Cleveland, Ohio, which will add 30,000 square feet, an increase of approximately 50%. It is expected that the Company will be reimbursed for the construction costs through a sale of the warehouse, which will thereafter be operated by the Company under a long-term lease arrangement.

In view of increased earnings, the quarterly dividend rate has been increased from 20¢ to 25¢, and the first dividend at the new increased rate will be paid on October 1, 1951. You may recall that in my letter to you of last year I stated my belief that the success of a company is in large measure dependent upon the incentive of those who are in a position to contribute most directly to its success. I am therefore very pleased to report that the rate of net profit of the Company was sufficient to permit the first distribution under the incentive bonus fund plan created in 1948 for certain officers and key employees other than the President. I am also pleased to report that the bonus plans for managers and district managers which were approved in 1950 have been very successful. In further recognition of the incentive principle, non-assignable 5-year stock options were granted during the year to certain officers and key employees. The option price was fixed at the then market value.

In order to further secure its financial position, the Company during the year borrowed $1,500,000 from a bank and an insurance company, using the proceeds to repay the existing loans and to add $300,000 to its working capital.

On the pages of this report next following this letter are printed pictures of some of the new stores. The Boardman store in Youngstown, Ohio, shown on page 6, is of particular interest as it is our first self-serve store. We hope that you will visit and patronize our stores and we assure you that any suggestions you may have will be sincerely welcomed. We are constantly searching for ways to increase our sales and promote economies.

I believe that the Company has had a satisfactory year and will continue to improve its condition.

Respectfully submitted,

Adolph Weinberger

President

Gray's New Store Opening Program

GRAY DRUG
Market St. at
Indianola Ave.
Youngstown, Ohio

On these pages we present views of several new stores recently opened by Gray's. The four stores shown here are the first steps in an expansion program involving nearly twenty new units, expected to be opened before the end of the coming fiscal year.

Interior View of
GRAY DRUG
Warren & Edgecliff Rds.
Cleveland, Ohio

GRAY DRUG
4309 Tuscarawas St., W.
Canton, Ohio

STORES DESIGNED WITH SALES IN MIND

A new Gray Drug Store doesn't "just happen." From original lease negotiations, to the planning-board conception, to the actual translation of blueprints into a well-operated store—every move is keynoted by one purpose: the designing of a store which functions as a selling machine.

Prescription Dept.
GRAY DRUG
Warren & Edgecliff Rds.
Cleveland, Ohio

FIRST GRAY'S
"Self-Serve" Drug Store

Although the introduction of "self-serve" merchandising in the drug industry is comparatively recent, Gray Drug has several stores of this type scheduled to open in the near future. The pictures on this page show views of Gray's first "self-serve" unit, recently opened at a new shopping center in Boardman, Ohio.

Interior View of
GRAY DRUG
"SELF-SERVE" STORE
Boardman, Ohio

Cosmetic Dept.
GRAY DRUG
"SELF-SERVE" STORE
Boardman, Ohio

ACCOUNTANTS' REPORT

Board of Directors,
Gray Drug Stores, Inc.,
Cleveland, Ohio.

We have examined the consolidated balance sheet of Gray Drug Stores, Inc., and subsidiaries as of June 30, 1951, and the related statements of consolidated profit and loss and surplus for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheet and statements of profit and loss and surplus present fairly the consolidated financial position of Gray Drug Stores, Inc., and subsidiaries at June 30, 1951, and the consolidated results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

ERNST & ERNST
Certified Public Accountants

Cleveland, Ohio
August 23, 1951

CONSOLIDATED BALANCE SHEET

ASSETS

CURRENT ASSETS			
Cash			$ 998,109
Accounts receivable, less allowance of $10,000			195,876
State tax stamps			58,690
Inventories—priced generally on the basis of the lower of cost (latest) or replacement market:			
At stores		$2,147,934	
At warehouse		1,413,813	
At laboratory		25,921	
		$3,587,668	
In transit		111,333	3,699,001
TOTAL CURRENT ASSETS			$4,951,676
OTHER ASSETS			
Cash surrender value of life insurance		$ 71,919	
Receivable for capital stock subscribed for by officers and employee		45,125	
Miscellaneous receivables, deposits, etc.		15,021	132,065
FIXED ASSETS—at cost, less allowances for depreciation and amortization			
Land		$ 26,309	
Building	$ 20,874		
Furniture and fixtures, etc.	1,702,840		
Leasehold improvements	1,154,701		
	$2,878,415		
Less allowances for depreciation and amortization	1,119,285	1,759,130	1,785,439
PATENTS AND TRADE-MARKS			1
DEFERRED CHARGES			
Prepaid insurance		$ 75,079	
Taxes		36,357	
Other		16,522	127,958
			$6,997,139

STORES, INC., AND SUBSIDIARIES, JUNE 30, 1951

LIABILITIES, CAPITAL STOCK, AND SURPLUS

CURRENT LIABILITIES			
Notes payable—portion due within one year			$ 108,940
Accounts payable:			
Trade accounts		$ 867,419	
Salaries, wages, and commissions		191,459	
Pay roll taxes and taxes withheld from employees		72,756	1,131,634
Accrued:			
Taxes (other than federal taxes on income)		$ 133,831	
Rent and interest		68,626	202,457
Federal taxes on income—estimated on the basis of Internal Revenue laws presently in effect			364,696
TOTAL CURRENT LIABILITIES			$1,807,727
LONG-TERM DEBT			
Notes payable:			
To insurance company—Note A	$1,200,000		
Less portion classified as current	8,940	$1,191,060	
To bank:			
Payable in semiannual installments of $50,000 each	$ 300,000		
Less portion classified as current	100,000	200,000	1,391,060
CAPITAL STOCK AND SURPLUS			
Capital stock (without par value):			
Authorized 150,000 shares (4,400 shares subject to stock options granted to certain officers and key employees on October 18, 1950, at $10.75 per share)			
Stated capital:			
Outstanding—140,150 shares	$1,711,650		
Subscribed — 2,375 shares	45,125	$1,756,775	
Surplus—Note A:			
Capital surplus		256,647	
Earned surplus		1,784,930	3,798,352
			$6,997,139

See notes to financial statements.

STATEMENT of CONSOLIDATED PROFIT and LOSS

GRAY DRUG STORES, INC., AND SUBSIDIARIES
Year ended June 30, 1951

Net sales		$16,833,818
Cost of goods sold		10,525,855
		$ 6,307,963
Selling, general, and administrative expenses		5,670,077
		$ 637,886
Other income:		
Gain on disposal of fixed assets	$ 34,323	
Revenue from telephones, etc.	23,395	
Miscellaneous	13,755	71,473
		$ 709,359
Interest on long-term debt		44,657
PROFIT BEFORE FEDERAL TAXES ON INCOME		$ 664,702
Federal taxes on income—estimated on the basis of Internal Revenue laws presently in effect:		
Normal tax and surtax	$ 292,800	
Excess profits tax	47,200	340,000
NET PROFIT		$ 324,702

See notes to financial statements.

STATEMENT of CONSOLIDATED SURPLUS

GRAY DRUG STORES, INC., AND SUBSIDIARIES
Year ended June 30, 1951

CAPITAL SURPLUS		
Balance at July 1, 1950, and June 30, 1951—no change during the year		$ 256,647
EARNED SURPLUS		
Balance at July 1, 1950		$1,572,118
Net profit for the year		324,702
		$1,896,820
Cash dividends declared:		
$.20 a share paid October 2, 1950	$ 27,800	
.20 a share paid January 2, 1951	28,030	
.20 a share paid April 2, 1951	28,030	
.20 a share paid July 2, 1951—Note B	28,030	111,890
BALANCE AT JUNE 30, 1951		$1,784,930

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

GRAY DRUG STORES, INC., AND SUBSIDIARIES
Year ended June 30, 1951

NOTE A

Under an agreement entered into on May 21, 1951, the Company issued its promissory note for $1,200,000 due on May 1, 1966, with interest at 3¾% per annum, payable in semiannual installments of $50,000 each beginning either November 1, 1954, or the May 1st or November 1st next succeeding the payment in full of the note payable to bank. In addition, the Company is required to make additional payments in each year to the extent of 20% of the excess of consolidated net profit for the preceding year over $280,000 (under such requirement the amount of $8,940 is payable on November 1, 1951); however, such additional payment in one year shall not exceed $100.000. The agreement includes, among other things, certain provisions relating to the maintenance of consolidated net current assets and certain restrictions on the payment of dividends. Accordingly, consolidated surplus available for dividends at June 30, 1951, amounted to $212,812.

NOTE B

On June 29, 1951, the Company deposited funds with the dividend disbursing agent for payment of the dividend payable July 2, 1951.

NOTE C

Allowances for depreciation and amortization aggregated $285,734 for the year.

NOTE D

Under the terms of the Pension Retirement Plan now in effect, the actuarially estimated annual cost including amortization of cost of past service benefits to retirement age of participants amounts to approximately $75,000.

GRAY DRUG STORES, INC.

OPERATING SEVENTY FIVE STORES
IN THE FOLLOWING CITIES:

OHIO

Akron
Alliance
Bedford
Barberton
Bexley
Canton
Cleveland
Cleveland Heights
Columbus
East Cleveland
Fremont
Garfield Heights
Lakewood
Mansfield
Massillon
Painesville
Rocky River
Sandusky
South Euclid
Steubenville
University Heights
Warren
Wooster
Youngstown

PENNSYLVANIA

Bradford
Erie
Kittanning
Punxsutawney

NEW YORK

Cortland
Elmira
Ithaca
Oneida